



FUNDING BOARD BRIEFING



Presenters

- **PHIL BREDESEN**, Governor
- **RILEY DARNELL**, Secretary of State
- **JOHN MORGAN**, Comptroller of the Treasury
- **DALE SIMS**, Treasurer

- **JERRY ADAMS**, Deputy Commissioner
Department of Finance & Administration
- **MARY-MARGARET COLLIER**, Director
Division of Bond Finance



Strategy - Year One

“Getting the Wings Level” (FY04)

Results:

- ✓ Corrected fundamental budget imbalance
- ✓ Made surgical cuts across state government — except for K-12 education
- ✓ Matched recurring revenue with recurring expenditures
- ✓ Closed FY04 with operating surplus



Strategy - Year Two

“Charting a New Course” (FY05)

Goals:

- ☐ Maintain fiscal stability through sound budgeting practices and responsible debt management
- ☐ Fully implement TennCare reform
- ☐ Make additional investments in K-12, higher education and economic development
- ☐ Further strengthen the Rainy Day Fund



Facts

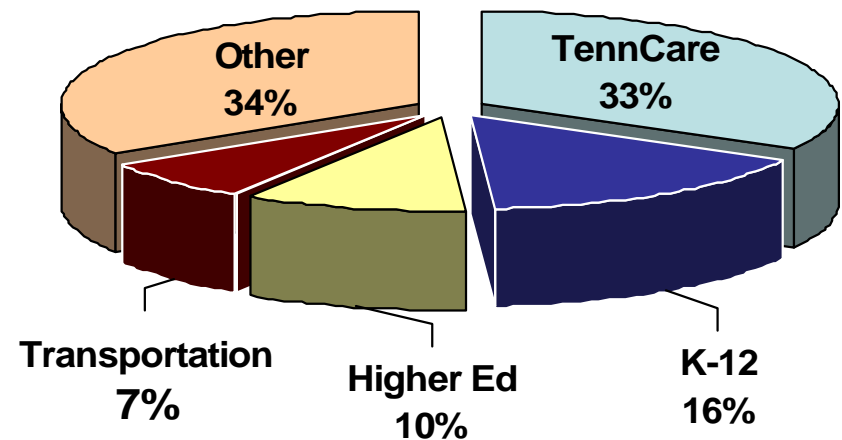
- The economy is improving
- Revenues are exceeding expectations
- We're getting back on track with key investments
- We're focused on responsible budgeting and TennCare reform



Budget Overview

Major budget categories include:

TennCare	\$8.02 B
K-12	\$3.86 B
Higher Ed	\$2.47 B
Transportation	\$1.62 B
Other	\$8.38 B



TOTAL \$24.35 BILLION



Budget Breakdown

Renewed budget growth is occurring as the **economy expands**

Source (millions)	FY04	PROJECTED FY05	Growth
State Funds	\$9,985	\$10,842	8.6%
Federal Funds	\$8,700	\$9,357	7.6%
Other*	\$3,585	\$4,154	15.9%
TOTAL	\$22,270	\$24,353	9.4%

** Includes bonds, interdepartmental revenues, tuition and fees*



Budget Breakdown (cont'd)

Fund (millions)	FY04	PROJECTED FY05	Growth
General/Education	\$19,782	\$21,277	7.6%
Transportation	\$1,444	\$1,620	12.2%
Debt Service	\$228	\$251	10.1%
Capital Outlay	\$70	\$398	468.6%
Facilities Revolving	\$100	\$136	36.0%
Cities & Counties (SST)	\$646	\$671	3.9%
TOTAL	\$22,270	\$24,353	9.4%



Revenue Overview

Overall revenue growth is healthy

Source (millions)	FY04	PROJECTED FY05	Growth
Taxes	\$8,987	\$9,368	4.2%
Federal Funds	\$8,700	\$9,357	7.6%
Departmental Revenue	\$2,750	\$2,871	4.4%
Other Taxes & Fees	\$908	\$927	2.1%
Tuition	\$745	\$790	6.0%
Tobacco Settlement	\$153	\$148	- 3.3%
Bonds*	\$90	\$494	448.9%
Reserves & Transfers	- \$203	\$398	296%
Essential Services Funds	\$140	—	N/A
TOTAL	\$22,270	\$24,353	9.4%

* Excluding bonds, revenue growth = 7.6%



Tax Collections

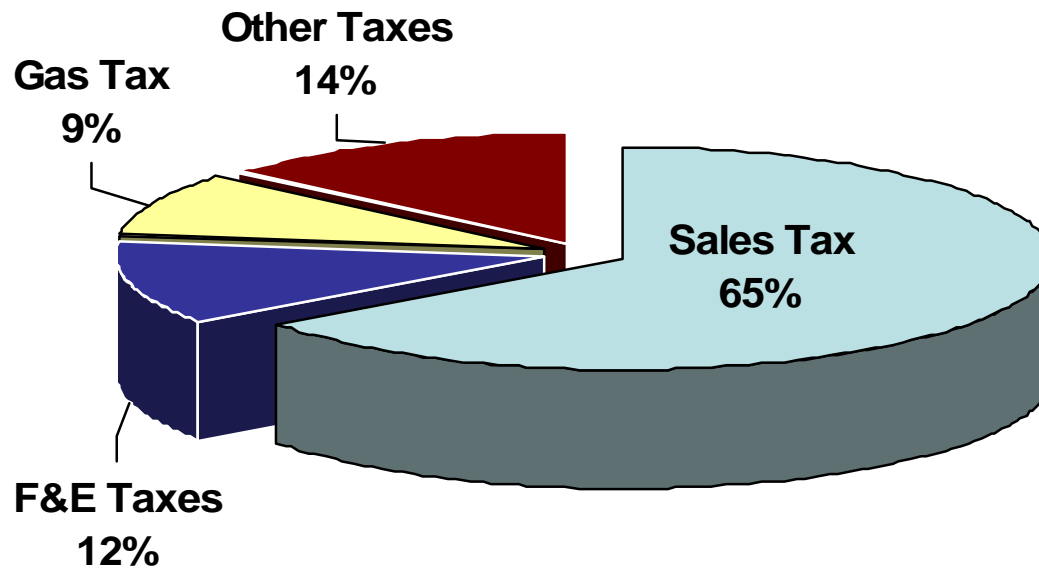
All tax sources are generating positive returns

Source (millions)	FY04	PROJECTED FY05	Growth
Sales	\$5,787	\$6,097	5.4%
Franchise & Excise	\$1,120	\$1,141	1.9%
Gas	\$834	\$853	2.3%
Motor Vehicle Reg.	\$234	\$244	4.3%
Privilege	\$250	\$255	2.0%
Gross Receipts	\$220	\$227	3.2%
Other	\$542	\$551	1.7%
TOTAL	\$8,987	\$9,368	4.2%



Tax Collections (cont'd)

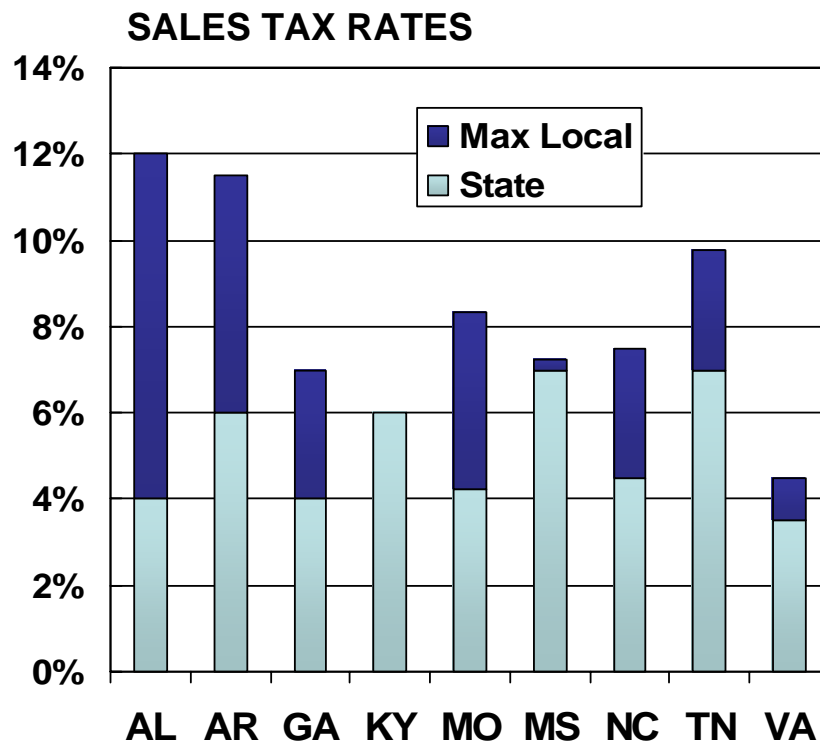
The sales tax accounts for 65% of Tennessee's total tax collections





Tax Collections (cont'd)

Tennessee's sales tax is high relative to other states but the state tax burden remains low



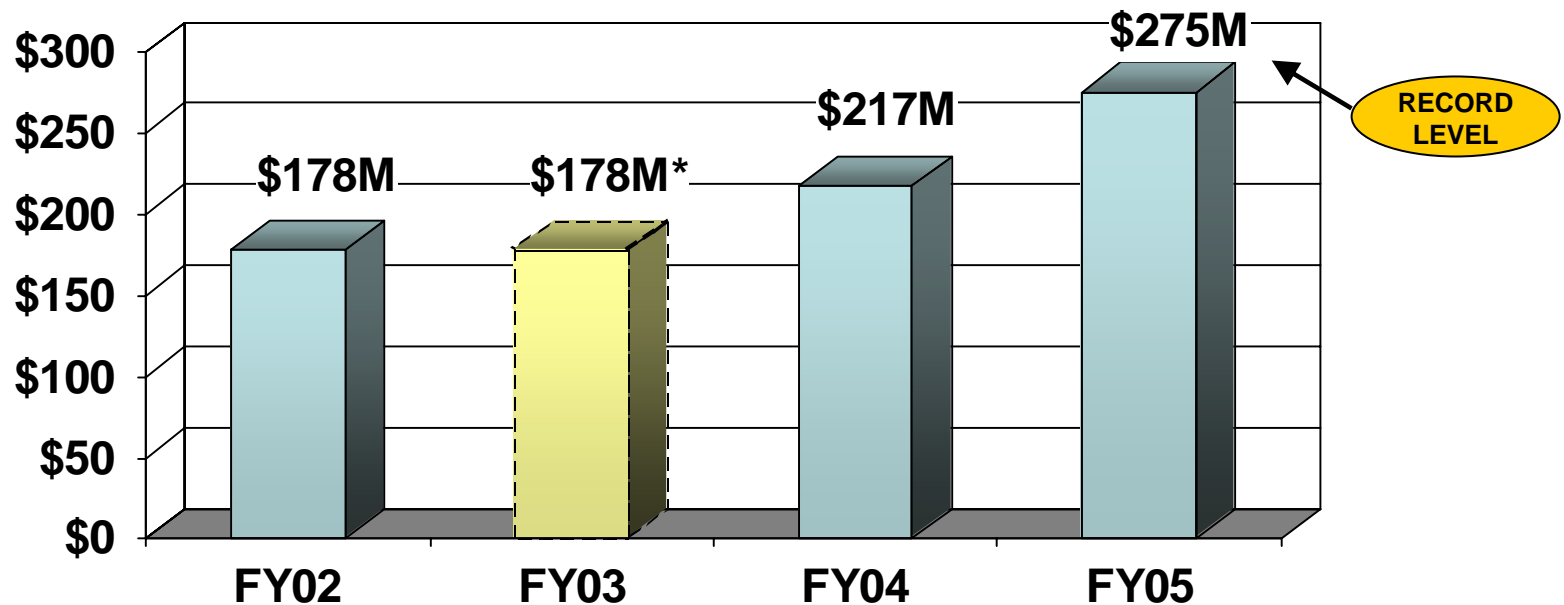
Rank	State	Per Capita Tax Burden
# 44	NH	\$1,521
# 45	MO	\$1,513
# 46	TN	\$1,508
# 47	CO	\$1,458
# 48	AL	\$1,426
# 49	SD	\$1,322
# 50	TX	\$1,316

Source: Sales Tax Institute, U.S. Census Bureau



Rainy Day Fund

Tennessee is **strengthening** its reserve fund through responsible fiscal management



** Fund would have been significantly reduced in late FY03, but Governor worked with CMS to renegotiate federal match cap in TennCare and the federal government released supplemental aid for essential services*



Retirement System

The Tennessee Consolidated Retirement System has a **proven track record**

- ✓ Since system consolidation in 1972, **every Governor** has recommended ... and **every General Assembly** has appropriated ... funds required to make employer contributions to the pension system in the amount recommended by the system's actuary
- ✓ FY05 budget includes an additional **\$73 million in recurring funds** to ensure TCRS remains actuarially sound



Retirement System (cont'd)

- 2003 Actuarial Evaluation set new employer contribution rates for July 1, 2004, through June 30, 2006

Group	Old Rate	New Rate
State employees	7.30%	10.54%
Teachers*	3.40	5.50
Local govt. employees	Rates vary	Rates vary

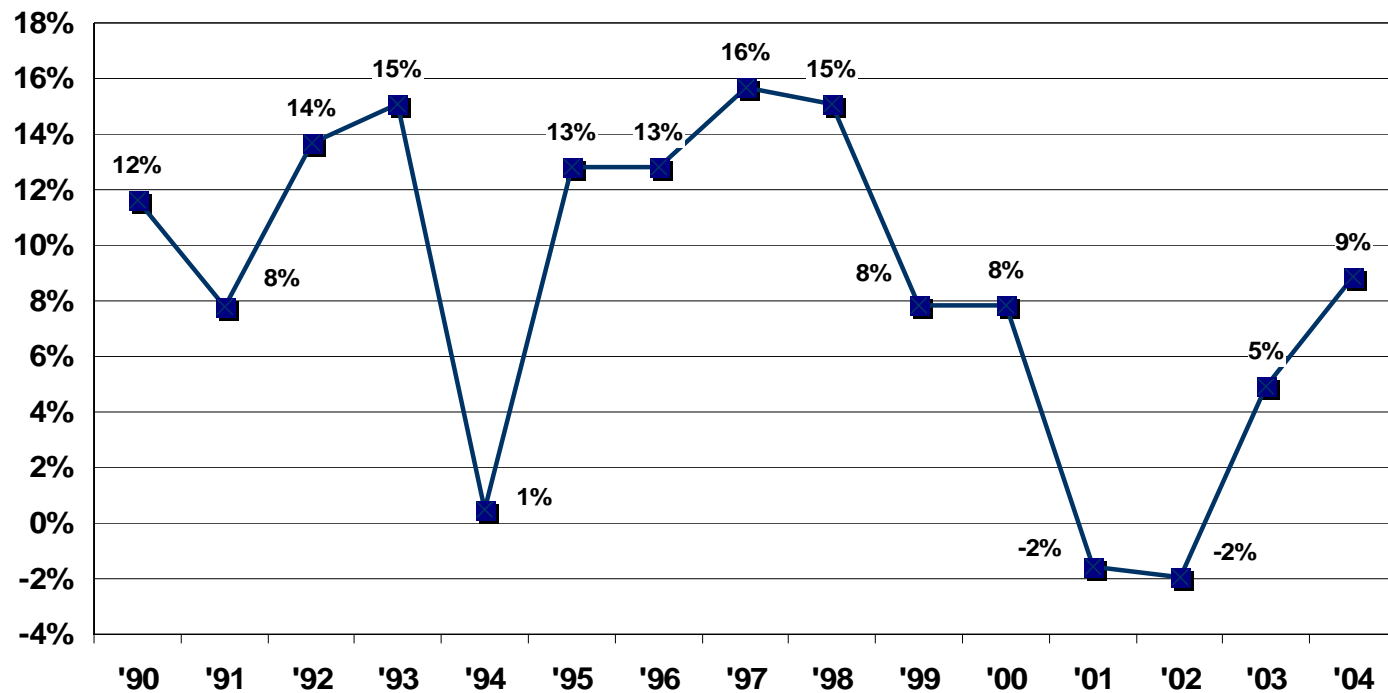
** Teachers required to contribute 5% of salary*

- Experience Study currently underway to examine economic and demographic assumptions
- 2005 Actuarial Evaluation to be completed in fall 2005, with new contribution rates taking effect July 1, 2006



Retirement System (cont'd)

For the period ending June 30, 2004,
10-year average return exceeded 8%





Top Priorities

In FY05, the Governor's management strategy is focused in **six areas** ...

- Strong debt management
- Effective TennCare reform
- Additional K-12 investments
- Increased job creation efforts
- Higher ed capital projects
- State employee pay raises



Debt Management

Improved fiscal situation includes
measured use of general obligation debt

Use (thousands)	FY05
Capital Projects*	\$309,580
Facilities Revolving Fund	\$25,000
Equipment Revolving Fund	\$20,000
Transportation	\$159,000
TOTAL	\$513,580

State still needs to
develop a long-range
capital plan

** Largest capital authorization since 1996*



Debt Management (cont'd)

- Debt service for authorized but unissued debt is included in operating budget

Auth. & Unissued Debt	\$ 1,570,994,785
Less Highway Debt	\$ 800,500,000
= Debt To Be Issued	\$ 770,494,785

Fiscal Year	Total Principal (thousands)	Cumulative Repayment	% Repaid
2005	\$98,890	98,890	8.65
2006-2010	420,630	519,520	45.44
2011-2015	346,765	866,285	75.77
2016-2020	198,480	1,064,765	93.12
2021-2029	78,530	1,143,295	100.00

- Tennessee repays its debt quickly



TennCare Reform

FY05 state improvements = \$246 million

- Reform strategy (see TennCare section) will produce an estimated **\$2 billion** in cost savings over the next four years

State Spending (billions)	PROJECTED FY05	→		
		FY06	FY07	FY08
TennCare (as is)	\$2.6	\$2.9	3.3	3.8
TennCare (Governor's reform)	\$2.5	\$2.6	2.7	2.8
COST SAVINGS	\$0.1	0.3	0.6	1.0

Source: McKinsey & Company



K-12 Investments

FY05 improvements = \$188 million — one in four available new dollars — including:

- \$55 million to **fully fund** Tennessee's Basic Education Program (BEP)
- \$108 million to **increase teacher pay** for more than 66,000 teachers statewide
 - \$35.0M to address issues related to equity in teacher pay
 - \$36.6M for a 2% permanent pay raise
 - \$36.6M for a 2% one-time bonus



K-12 Investments (cont'd)

Teacher pay investments address **critical issues**

- ✓ **Competitiveness:** TN is hitting a milestone ... average teacher pay is expected to rise **above the Southeastern average** to \$43,500, making it easier to recruit and retain the best teachers
- ✓ **Small Schools Case:** Plaintiffs in a longstanding court action against the state **endorsed the Governor's strategy** for addressing teacher pay equity issues



K-12 Investments (cont'd)

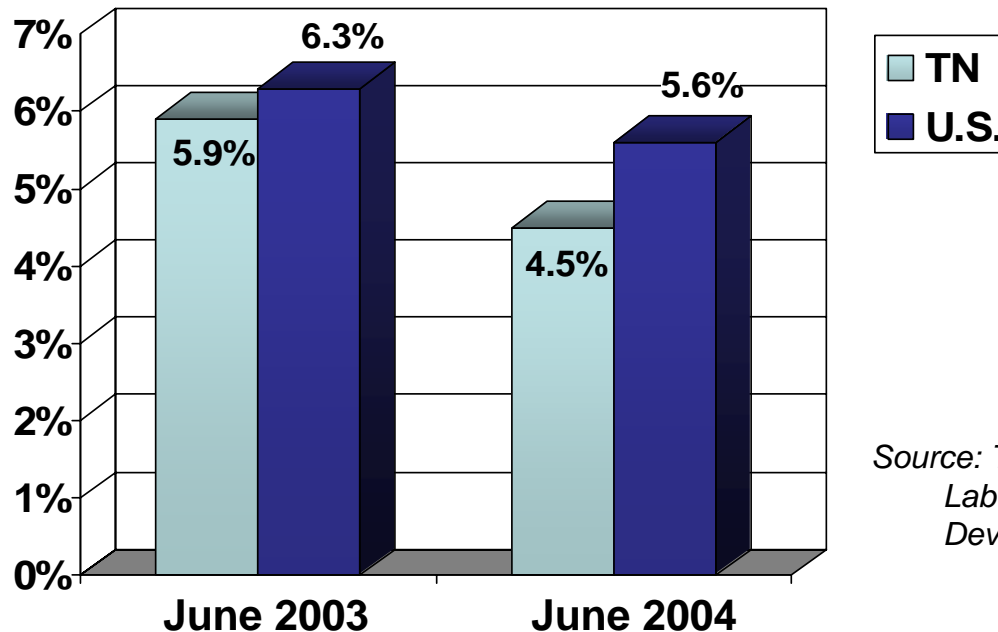
Modest investments in new initiatives help lay the groundwork for improvement

- **Imagination Library**: \$2 million in “challenge grants” to launch statewide reading program
- **Classroom Technology**: \$2 million “down payment” for schools to purchase new software
- **Teach Tennessee**: \$500,000 in “seed money” to attract mid-career professionals to teach in underserved school districts



Job Creation

Tennessee's unemployment rate **remains lower** ... and is falling faster ... than the national average



Source: TN Department of
Labor & Workforce
Development



Job Creation (cont'd)

Companies adding new jobs include fast-growing operations as well as long-established household names



U.S. XPRESS ENTERPRISES, INC.



Job Creation (cont'd)

From July 2003 to June 2004, new and expanding companies announced **31,500 new jobs** in TN

TOP 10 ANNOUNCEMENTS BY JOBS

County	Company	Type	Jobs
Shelby	FedEx	Expansion	1,346
Hamilton	U.S. Express	Expansion	1,000
Robertson	Electrolux N.A.	Expansion	744
Anderson	Omega Cabinetry	New	600
Davidson	Asurion	New	600
Rutherford	Cinram	New	600
Rutherford	Nissan N.A.	Expansion	527
Franklin	Nissan N.A.	Expansion	492
Sullivan	King Pharmaceuticals	Expansion	417
Anderson	Homecrest	Expansion	408

*Source: TN Department of
Economic & Community
Development*



Job Creation (cont'd)

New policies and initiatives are expected to yield dividends in economic growth

- After the Governor proposed ... and the General Assembly approved ... workers' comp reform, NCCI recommended **lowering rates** by 6% in Tennessee
- Governor's "FastTrack" program is **cutting red tape** for infrastructure development and job training
- Spin-off benefits will be generated by **research and technology initiatives** such as ORNL's new supercomputing and fusion projects, and the Memphis Biotech Foundation's new campus (funded in part by a \$10M state capital grant)

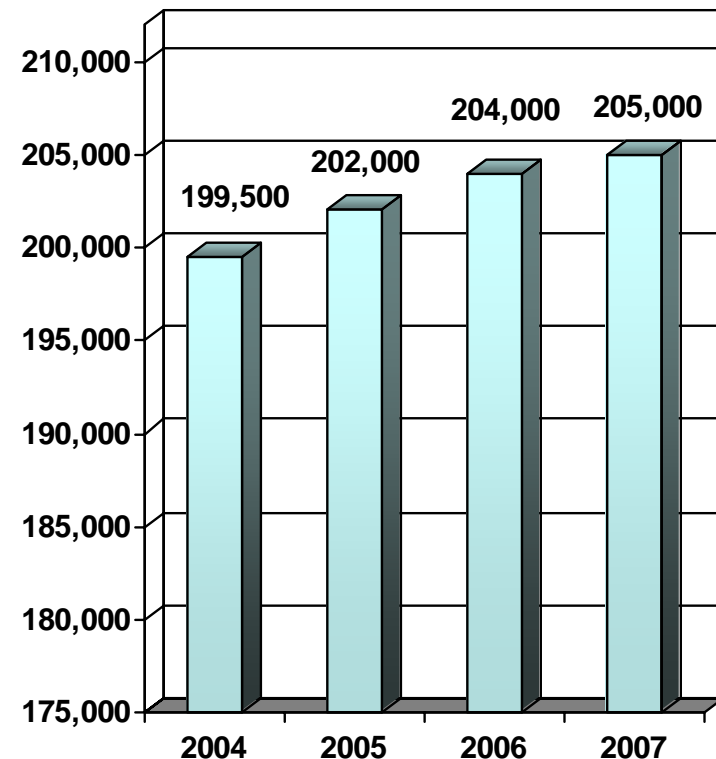




Higher Ed

- FY05 budget funds the **11 highest-priority** capital projects totaling \$141.8 million (\$134.1 million in bonds, plus \$7.7 million in cash)
- Budget also funds \$78.0 million in **much-needed capital maintenance** statewide

Rising enrollment driving increased capital investment



Source: TN Higher Education Commission



Higher Ed (cont'd)

Campus capital projects span the state

Institution	Project	Cost
Austin Peay State Univ.	McCord Building renovation	\$7.3 million
Dyersburg State CC	Facilities renovations	\$10.3 million
East TN State Univ.	Sherrod Library renovation	\$11.0 million
Motlow State CC	New library, renovation	\$10.0 million
Northeast State Tech CC	New Humanities building	\$14.9 million
Pellissippi State Tech CC	New academic building	\$6.7 million
Regents System	Purchase-replacement fund	\$3.3 million
Southwest TN CC	Planning new campus	\$520,000
UT Health Science Ctr.	College of Pharmacy building	\$42.8 million
UT-Knoxville	Glocker building renovation	\$30.4 million
Walters State CC	College Center renovation	\$4.6 million



Employee Pay Raises

FY05 improvements = \$160 million including:

- \$11 million to adjust **classification and compensation** levels
- \$27 million to fund state match for **increased health insurance premiums**
- \$122 million to **increase pay** for more than 64,000 state and higher ed employees statewide
 - \$73.2M to fund a 3% permanent pay raise (\$48.6M through state tax appropriations and \$24.6M through higher ed budgets)
 - \$48.8M to fund a 2% one-time bonus for state employees and higher ed employees



Other Issues

- Lottery startup
- Restoring cuts
- Possible risks



Lottery Startup

- The Tennessee Education Lottery Corp. launched its first games **January 20**
- By the end of FY04, the Lottery had generated **\$123 million in net proceeds**
- Lottery-funded scholarships are helping offset a **7% tuition increase** at state colleges and universities
- Scholarship amounts are: **\$3,000** for a four-year institution and **\$1,500** for a two-year institution



Lottery Startup

Lottery proceeds are adequately funding scholarships

FINANCIAL DATA

Estimates of Net Lottery Proceeds

FY 2004	\$105,052,000
FY 2005	\$199,777,000

Estimates of Scholarship Values

FY 2004	N/A
FY 2005	\$176,552,000

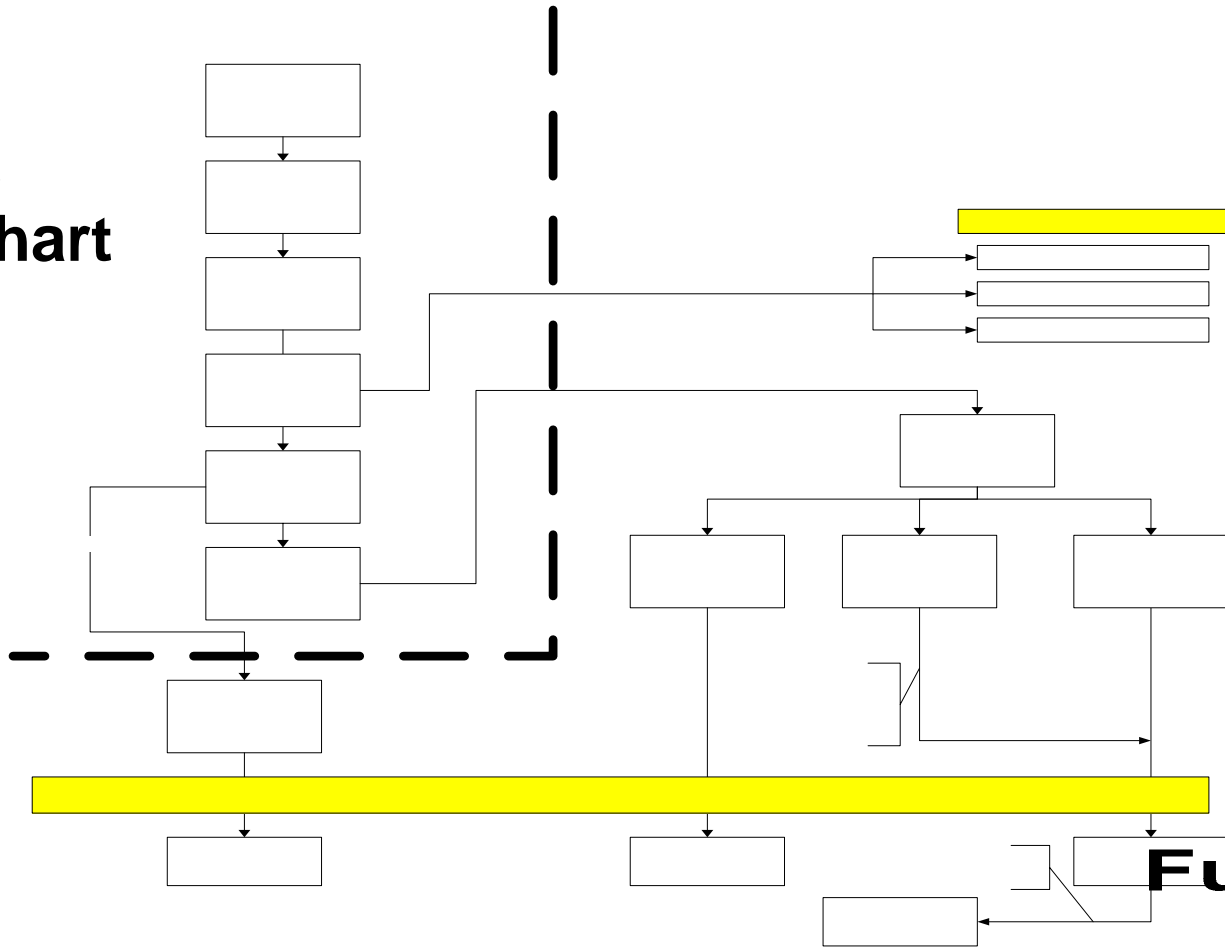
	Net Lottery Proceeds	Deposits Distributed to -			Payments from Scholarship Account				Scholarship Account Balance	Scholarship Funding Over (Under) Scholarship Requirements
		Gen. Shortfall Reserve = 5%	Local Gov't Reserve = 1%	Scholarship Account = 94%	THEC & TSAC Adm. Costs	Scholarship Payment	Pre-K Programs	Total Payments		
April 15, 2004	\$63,774,000	\$3,188,700	\$637,740	\$59,947,560	(\$448,499)	\$0	\$0	(\$448,499)	\$59,499,062	
July 15, 2004	\$41,278,000	\$2,063,900	\$412,780	\$38,801,320	(\$448,499)	\$0	\$0	(\$448,499)	\$97,851,883	
FY 2004	\$105,052,000	\$5,252,600	\$1,050,520	\$98,748,880	(\$896,997)	\$0	\$0	(\$896,997)		\$97,851,883
August 20, 2004	\$0	\$0	\$0	\$0	\$0	(\$88,276,000)	\$0	(\$88,276,000)	\$9,575,883	
October 15, 2004	\$49,944,250	\$2,497,213	\$499,443	\$46,947,595	\$0	\$0	\$0	\$0	\$56,523,478	
January 15, 2005	\$49,944,250	\$2,497,213	\$499,443	\$46,947,595	(\$1,061,350)	\$0	\$0	(\$1,061,350)	\$102,409,723	
January 20, 2005	\$0	\$0	\$0	\$0	\$0	(\$88,276,000)	\$0	(\$88,276,000)	\$14,133,723	
April 15, 2005	\$49,944,250	\$2,497,213	\$499,443	\$46,947,595	\$0	\$0	\$0	\$0	\$61,081,318	
July 15, 2005	\$49,944,250	\$2,497,213	\$499,443	\$46,947,595	(\$1,061,350)	\$0	\$0	(\$1,061,350)	\$106,967,563	
FY 2005	\$199,777,000	\$9,988,850	\$1,997,770	\$187,790,380	(\$2,122,700)	(\$176,552,000)	\$0	(\$178,674,700)		\$9,115,680

Source: State Funding Board



Lottery Startup (cont'd)

**Funds
Flowchart**





Restoring Cuts

- Governor has committed to restoring to local governments \$35 million (recurring) in shared tax funds that were cut in FY04
- Half the funds (\$17.5M) will be restored in FY06 and the other half (\$17.5M) in FY07



Possible Risks

- Unsustained economic recovery
- Uncertainties surrounding possible future terrorist attacks
- Federal approval of TennCare reform not assured
- TennCare reform could be jeopardized by litigation from enrollee advocates



Bottom Line

To reiterate ...

- The economy is improving
- Revenues are exceeding expectations
- We're getting back on track with key investments
- We're focused on responsible budgeting and TennCare reform